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# Message Text

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ACTION EB-11

INFO OCT-01 EUR-25 EA-11 ISO-00 AEC-11 AID-20 CEA-02

CIAE-00 CIEP-02 COME-00 DODE-00 FEA-02 FPC-01 H-03

INR-10 INT-08 L-03 NSAE-00 NSC-10 OMB-01 PM-07 RSC-01

SAM-01 SCI-06 SPC-03 SS-20 STR-08 TRSE-00 NEA-10

FRB-02 XMB-07 OPIC-12 LAB-06 SIL-01 DRC-01 PA-04

PRS-01 USIA-15 /226 W
---------- 007179
P R 221615Z FEB 74
FM AMEMBASSY ROME
TO SECSTATE WASHDC PRIORITY 3396
INFO AMEMBASSY BERN
AMEMBASSY BONN
AMEMBASSY BRUSSELS
AMEMBASSY LONDON
AMEMBASSY PARIS
AMEMBASSY TOKYO

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E.O. 11652: N/A
TAGS: EFIN, IT
SUBJECT: WORLD MONETARY AND TRADE RELATIONSHIPS C-ER-4-57864

REF: (A) STATE 032727
(B) ROME 1847
(C) ROME 11369
(D) ROME 11314
(E) ROME 2512

1. FOLLOWING ARE REPLIES TO QUESTIONS RAISED IN PARAS
1-7 OF REFTEL A.

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2. PARA 1: WE HAVE NO CLEAR EVIDENCE AS TO WHAT PRESENT

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GOI AIM IS WITH REGARD TO LIRA EXCHANGE RATES AGAINST
DOLLAR AND OTHER EUROPEAN CURRENCIES. OUR IMPRESSION
IS THAT ITALIANS WOULD FIND WEIGHTED AVERAGE LIRA
DEPRECIATION OF PERHAPS 20-25 PERCENT ABOVE PRE-SMITHSONIAN
RATES (OR ABOUT 20 PERCENT ABOVE SMITHSONIAN RATES ) ACCEPTABLE.
WHATEVER PREFERENCES MAY BE, IN VIEW OF SERIOUS
ITALIAN BALANCE OF PAYMENTS SITUATION, AUTHORITIES MAY
NOT BE ABLE TO HOLD LIRA RATE WITHIN DESIRED RANGES.
ON OTHER HAND, FEAR OF DOMESTIC INFLATIONARY REPERCUSSIONS
IS IMPORTANT FACTOR BEHIND ITALIAN RESISTANCE TO
FURTHER LIRA DEVALUATION.

3. PARA 2: ALTHOUGH ITALIAN GROSS RESERVES REMAIN
HIGH, LARGE PART IS TIED UP IN GOLD WHICH ITALIANS ARE
RELUCTANT TO USE FOR INTRA-CENTRAL BANK SETTLEMENTS OR
FOR SALES IN FREE MARKET PENDING RESOLUTION OF OFFICIAL
GOLD PRICE QUESTION. IN ANY CASE, RESERVES HAVE ALREADY
BEEN MORTGAGED AT MEDIUM-TO LONG-TERM AS A RESULT
OF MASSIVE EUROMARKET BORROWINGS, ESPECIALLY IN 1973.
THEREFORE, ITALIANS ARE NOT PREPARED TO ALLOW SIGNIFICANT
REDUCTION IN GROSS OFFICIAL RESERVES IF THIS CAN BE
AVOIDED. FOR EXAMPLE, IN 1973 NET OFFICIAL ASSETS
DECLINED BY ONLY $293 MILLION, DESPITE UNDERLYING
DEFICIT OF $4.8 BILLION (EXCLUDING COMPENSATORY
EUROMARKET BORROWING). ITALIANS WOULD, OF COURSE, BE
DELIGHTED TO ABSORB RESERVES TO MAINTAIN PRESENT
CURRENCY RATES IF THIS WERE REALISTIC POSSIBILITY.
CURRENCIES WHICH ITALY CONSIDERS MOST IMPORTANT IN TERMS
OF MANAGING LIRA EXCHANGE RATE ARE DM, FRENCH FRANC,
DOLLAR, GUILDER, POUND STERLING, BELGINN FRANC AND
SWISS FRANC. DEVALUATION OF COMMERCIAL LIRA ON
FEBRUARY 21 FROM PRE-SMITHSONIAN RATES AGAINST CURRENCIES
OF ITALY'S MAJOR TRADING PARTNERS IN APPROXIMATE ORDER
OF IMPORTANCE WAS: DEUTSCHMARK 42 PERCENT, FRENCH FRANC 17
PERCENT, US DOLLAR 4 PERCENT, DUTCH GUILDER 35 PERCENT, BELGAIN
FRANC 28 PERCENT AND SWISS FRANC 44 PERCENT.
LIRA HAD APPRECIATED AGAINST UK
POUND BY LESS THAT 1 PERCENT. AS RESULT OF EXPECTED RELATIVE
STRENGTH OF US DOLLAR DURING ENERGY CRISIS, ITALIANS
MIGHT NOT OBJECT TO INCREASED DEPRECIATION OF LIRA
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AGAINST DOLLAR. THEY WOULD ALSO LIKELY WANT TO AVOID
ANY LOSS OF CURRENT DEVALUATION EDGE AGAINST FRENCH
FRANC, BUT MIGHT BE LESS CONCERNED ABOUT OTHER MAJOR
CURRENCIES.

4. PARA 3: ITALIAN POSITION RE PROPOSALS FOR RULES
FOR FLOATING IN C-20 SHOULD BE WELL KNOWN TO WASHINGTON
PARTICIPANTS IN WORK OF C-20. BASICALLY, ITALIANS

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SUPPORT FLOATING RATES AS ACCEPTABLE OPTION FOR GOVERNMENTS, EVEN ON PERMANENT BASIS, BUT RECOGNIZE NEED FOR RULES TO AVOID COMPETITIVE DEVALUATIONS OR EVEN REVALUATIONS. ITALIANS HAVE STRESSED NEED FOR RULES PARTICULARLY DURING PRESENT INTERIM PERIOD WHEN FLOATING IS WIDESPREAD AND OFFICIAL MARKET INTERVENTION IS COMMON BUT SUBJECT TO NO FORMAL RULES. ITALIANS HAVE BEEN WILLING TO ACCEPT RESERVE INDICATORS AS ONE BASIS FOR JUDGING CORRECTNESS OF EXCHANGE MARKET INTERVENTION BUT WANT OTHER FACTORS TO BE CONSIDERED.

5. PARA 4: ITALIANS HAVE HISTORICALLLY, AND PARTICULARLY IN 1973, MADE USE OF MASSIVE FOREIGN COMPENSATORY BORROWING TO FINANCE BALANCE OF PAYMENTS DEFICITS AND HAVE ENCOURAGED SUBSEQUENT ADVANCE REPAYMENTS OF SUCH LOANS
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